STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JAMES CORNELL	:	DETERMINATION DTA NO. 818369
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1997 and 1998.	:	

Petitioner, James Cornell, 13166 Bigtree Road, East Aurora, New York 14052, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1997 and 1998.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 77 Broadway, Buffalo, New York 14203, on November 27, 2001, at 10:30 A.M., with all briefs to be submitted by July 8, 2002, which date began the six-month period for the issuance of this determination. Petitioner appeared by Equity Search (James T. Rindfleisch, E.A.). The Division of Taxation appeared by Barbara G. Billet, Esq. (Barbara J. Russo, Esq., of counsel).

ISSUE

Whether petitioner was a responsible person and liable for penalties under Tax Law § 685(g) for willful failure to pay withholding taxes of Tensar Industries for the period August 23, 1997 through September 30, 1998.

FINDINGS OF FACT

1. The Division of Taxation ("Division") issued Notices of Deficiency dated March 20, 2000, to petitioner, James Cornell, under Notice Numbers L-017478489 and L-017478488, as an officer and responsible person for Tensar Industries, Inc. ("Tensar Industries") pursuant to Tax Law § 685(g) for withholding taxes for the period August 23, 1997 through September 30, 1998.

2. A conciliation conference was held before the Bureau of Conciliation and Mediation Services pursuant to petitioner's request on August 15, 2000. The aforementioned notices were sustained by conciliation Order No. 180188, dated November 24, 2000.

3. Petitioner does not dispute that he is a person responsible for withholding tax for Tensar Industries, and only argues that he was not "willful."

4. Tensar Industries, successor to Tensar Structures, was a business in the field of ground-mounted air structures and domes, such as golf, soccer and tennis domes, with offices in New York. The majority owner of Tensar Structures was George "Skip" Reitmeier, III ("Skip Reitmeier"). Tensar Structures struggled financially and filed for bankruptcy under Chapter 11 in or about 1986 or 1987. Thereafter, the company reorganized and recovered from the Chapter 11 status. In the early 1990s, Tensar Structures involved itself with government contracts, particularly a project for Dessert Storm for biological warfare shelters. Skip Reitmeier negotiated the contract and failed to include some key provisions to protect Tensar Structures. As a result, the company found itself in a payment dispute of several million dollars with the government, and again in 1993 or 1994 filed for bankruptcy under Chapter 11.

In 1993 or 1994 petitioner was approached by individuals from Tensar Structures, specifically Don Mumbach, a Tensar Structures board member, to help turn the company around, an expertise petitioner had developed in addition to his experience with government contracts.

Tensar Structures' bankruptcy was converted from Chapter 11 to Chapter 7. As a part of the bankruptcy plan, the assets of Tensar Structures were sold to Tensar Industries.

5. Tensar Industries became a wholly-owned subsidiary of London Norway Corp., a real estate holding company primarily in the self storage business. At the time of London Norway's purchase of Tensar Industries' capital stock, petitioner owned 50% of London Norway. During the period in issue, petitioner became a 100% owner of London Norway.

6. Petitioner's objective for Tensar Industries was to return the company to profitability and eventually sell the business back to the previous owner, Skip Reitmeier. Petitioner believed that Skip Reitmeier was very qualified to run the business, since his father was the engineer who invented the technology for the structure industry and gave his son Skip the assistance to form the previous business of Tensar Structures. Between 1995 and 1997, the first two years of petitioner's involvement, petitioner worked closely with Skip Reitmeier and Michael Moore, brought in as controller, on the rebuilding of the company. During that time, all taxes were paid and the company experienced a dramatic increase in business volume.

7. In June 1997, as a part of his other business interests, petitioner secured a consulting contract which required his presence in Washington, D.C. on a substantial basis. He evaluated the situation and determined he had confidence in Skip Reitmeier to run Tensar Industries and met with him to outline his duties and responsibilities to run the business. Skip Reitmeier was to report directly to petitioner and did so on nearly a daily basis, either by phone or e-mail. During the time petitioner spent traveling to Washington, he did not review the bank statements to determine whether there was sufficient money to cover checks or whether checks written had posted and cleared. However, petitioner was always assured by Mr. Reitmeier that the business was running smoothly and all bills, including taxes, were being paid.

8. Petitioner was president of Tensar Industries and received 100% of his earned income from Tensar Industries in 1997. Petitioner, as president, Skip Reitmeier, as executive vice president, and Michael Moore, as controller, were signatories on the bank account or Tensar Industries, and all three had authority to sign checks.

9. Petitioner had authority to sign withholding tax returns on behalf of Tensar Industries, authority to sign contracts and obtain loans for the company, authority to supervise employees, authority to review business mail, and authority to review the company's bank statements and corporate books. Petitioner was responsible for supervising Skip Reitmeier. Michael Moore answered to Skip Reitmeier in petitioner's absence. Petitioner, as well as London Norway, loaned substantial capital to Tensar Industries. Petitioner devoted about one-third of his time to Tensar Industries in 1997, and much less in 1998.

10. As executive vice president of Tensar Industries, Skip Reitmeier had a management responsibility to manage and direct all the affairs of all the departments of the company. He was not merely a salesman; he was the executive manager of the company familiar with all the facts and circumstances of its operations.

11. Tensar Industries paid other bills and expenses, other than withholding taxes, during the years at issue.

12. Tensar Industries withheld taxes from its employee's paychecks and failed to pay some portion of such withholding taxes to New York State for the periods at issue. However, during the periods in issue, some sporadic tax deposits were made.

13. In May 1998, petitioner discovered that Michael Moore, Tensar Industries' controller, had been embezzling from Tensar Industries. Correspondence from New York State concerning unfiled tax returns was found, and after an investigation, it was determined that Moore had not

been paying withholding taxes, but instead had been diverting company funds for his own benefit. Mr. Moore was immediately fired and replaced by an outside accountant, who undertook the daunting task of reconciling the past business activity. At that time, petitioner took control of the payment of taxes. During the period of investigation, the business continued to pay various business expenses necessary to keep the business operating. With the exception of the very next period ending September 30, 1998, as the investigation continued, the withholding taxes were paid as they accrued until the business closed its operations in June 1999.

14. Unbeknownst to petitioner, Skip Reitmeier filed a business certificate with the Erie County Clerk's Office in May 1998, indicating he was doing business under the assumed name and business identity of Writefield. A later investigation into Skip Reitmeier's business activities revealed he was diverting Tensar Industries' funds, contracts, products, trade secrets and bids to the public and competitors to his newly-formed company, Writefield. As petitioner was uncovering the wrongdoing on the part of Skip Reitmeier, Tensar Industries continued to pay its operating expenses, such as heat, electricity and payroll. Beginning at the end of 1998 and by the spring of 1999, petitioner learned of the unpaid withholding taxes. In April 1999, petitioner brought a lawsuit against Skip Reitmeier. After the discovery of wrongdoings by Skip Reitmeier and commencement of the lawsuit against him, petitioner continued to pay operating expenses, payroll, and current tax deposits as required. The prior liability for withholding taxes at issue herein were not paid at that time because petitioner had not determined with certainty what was due and owing.

15. Petitioner reviewed checks written by Tensar Industries for the period in issue and determined that of 762 checks, he signed 12, and 21 bore his name, though forged by another

party. The remaining checks were predominately signed by Skip Reitmeier or Michael Moore or both.

16. During the period in issue, petitioner's educational background and business experience was derived from a high school education and 21 years in a variety of business dealings. His primary concentration was in the areas of real estate transactions, government contracts, troubled companies and labor contract negotiations.

17. The Division submitted 25 proposed findings of fact. Proposed facts 13, 18, 20, 21, and 22 were modified to more clearly reflect the record. Proposed fact 16 was rejected as not supported by the record. The remaining facts were incorporated above.

SUMMARY OF THE PARTIES' POSITIONS

18. Petitioner agrees he is a responsible person in accordance with Tax Law § 685(g), but maintains that his failure to pay over withholding taxes due by Tensar Industries was not willful.

19. The Division argues that petitioner cannot absolve himself by disregarding his duty and leaving it to someone else to discharge, especially if he chooses to make an unreasonable delegation of authority, as here. Accordingly, the Division maintains petitioner's conduct should be deemed willful within the meaning of Tax Law § 685(g).

CONCLUSIONS OF LAW

A. Tax Law § 685(g) provides:

> [w]illful failure to collect and pay over tax.--Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

Tax Law § 685(n) makes the following "persons" subject to the section 685(g) penalty:

> an individual, corporation, partnership or limited liability company or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, or a member, manager or employee of a limited liability company, who as such officer, employee, manager or member is under a duty to perform the act in respect of which the violation occurs.

In ***Matter of Levin v. Gallman*** (42 NY2d 32, 396 NYS2d 623), the Court stated that the test for willfulness is:

> whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes . . . . No showing of intent to deprive the Government of its money is necessary but only something more than accidental non-payment is required (***Matter of Levin v. Gallman***, ***supra***, 396 NYS2d, at 624-625).

The Tax Appeals Tribunal noted in ***Matter of Gallo*** (September 9, 1988) that:

> a responsible officer's failure can be willful, notwithstanding his lack of actual knowledge, if it is determined the officer recklessly disregarded his corporate responsibilities including the responsibility to see that taxes were paid (***Matter of Gallo***, ***supra***, ***citing Matter of Capoccia v. State Tax Comm.***, 105 AD2d 528, 481 NYS2d 476; ***Matter of Ragonesi v. State Tax Comm***., 88 AD2d 707, 451 NYS2d 301).

With regard to the issue of whether petitioner was a person within the definition in Tax Law § 685(n), petitioner concedes he was a responsible officer in accordance with the Tax Law, and thus, this element is not further discussed.

B. The Division claims petitioner's argument that he was not willful is similar to that made in ***Matter of Capoccia v. State Tax Comm***. (***supra***) and ***Matter of Risoli v. Commr. Of Taxation and Finance*** (237 AD2d 675, 654 NYS2d 218), and should likewise be rejected. In ***Capoccia,*** the petitioner claimed he was not willful where he was president and principal shareholder of a construction business, and the other principal of the business was corporate secretary-treasurer, whose function was to maintain the corporate books and records. Although petitioner had access to the books and records, he elected to concern himself only with the

corporation's field operations, claiming he did not understand the books. The Court rejected petitioner's argument that he was not willful, holding that corporate officials could not absolve themselves merely by disregarding their duty and leaving it to someone else to discharge, citing ***Matter of Ragonesi v. New York State Tax Comm***. (***supra***). In ***Risoli***, the Court came to the same conclusion after the petitioner therein argued that he delegated the tax collection and payment responsibilities to other corporate shareholders and relied on their representations that the taxes were being paid.

In this case, petitioner did not disregard his duties or delegate them without followup and management oversight. Petitioner worked with Michael Moore and Skip Reitmeier between 1995 and 1997, at a critical point in the viability of Tensar Industries. He developed good working relationships with the two men and evaluated their ability to conduct the sales management and financial management of the company's daily operations. When he made a decision to commit to consulting work away from Tensar Industries, he had a reasonable basis upon which to rely on their ability and integrity. Michael Moore had worked with petitioner in other companies with which he was involved. Skip Reitmeier had a vested interest in Tensar Industries' comeback. Not only was it his livelihood, but the successor company to his father's creation of ground-mounted air structures and domes. Unlike this case, in ***Capoccia***, there was no allegation of deceit or embezzlement behind which the other members of the corporation management hid. Unlike ***Risoli***, where the reliance upon petitioner's brother, a man with known gambling habits facing a business already in trouble, was unreasonable, James Cornell reasonably trusted and relied upon men he had worked side by side with for more than two years restoring the company. The reasonableness of petitioner's reliance on Skip Reitmeier is not undermined by the business failure of Tensar Structures, since the primary cause for its demise

was a more than $2 million government contract that soured, leaving the company in a poor position. This is quite different from Skip Reitmeier's deliberate theft of corporate secrets and corporate funds and diversion thereof to another company for his own benefit. Petitioner's signature was forged on numerous checks without his knowledge, further supporting the conclusion that he was deceived and manipulated by Skip Reitmeier and Michael Moore.

C. The penalty imposed by Tax Law § 685(g) is modeled after section 6672 of the Internal Revenue Code, and as a result, Federal cases may be used for guidance (***Yellin v. New York State Tax Commission***, 81 AD2d 196, 440 NYS2d 382). In support of its position, Division cites several Federal cases that speak to "reckless disregard" of one's duty to pay the appropriate taxes. The United States District Court in ***Internal Revenue Service v. Blais*** (612 F Supp 700, 710 [D Mass]) summarizes fact patterns from which a reckless disregard sufficient to demonstrate willfulness in section 6672 is inferred:

> First, courts have held that reliance upon the statements of a person in control of the finances of a company may constitute reckless disregard when the circumstances show that the responsible person knew that the person making the statements was unreliable. This requires a finding that the responsible person had knowledge that the other individual had in the past failed to perform adequately with regard to the financial affairs of the taxpayer entity. . . .
>
> Second, the courts have held that '[w]illful conduct also includes failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.' This requires a finding that the responsible person had 'notice' that the taxes had not been remitted in the past. . . .
>
> Third, courts have found that when a responsible person continues to pay other bills knowing that the business is in financial trouble, he willfully violates § 6672 if he fails to make reasonable inquiry as to whether money would or would not be available for payment of the taxes when they became due.

Petitioner provided undeniably credible testimony concerning his assessment of all the facts of this case. The reasonable reliance upon Michael Moore and Skip Reitmeier has been discussed and established above. Clearly, after the mismanagement was detected the individuals

responsible for the deceit and mismanagement were immediately taken out of their respective positions, and charges filed. Additionally, petitioner hired skilled outside accountants and attorneys to perform forensic investigative procedures to uncover the problems to their fullest extent and attempt a resolution of them as promptly as possible. Once petitioner determined the extent of liability facing the company and uncovered the unpaid withholding taxes, he sought to correct the problems. Petitioner's attempt to keep the company afloat by payment of heat, utilities, payroll and tax deposits in the midst of an egregious abuse committed by others was not payment of unnecessary expenditures and cannot be the basis for a finding of willfulness.

In ***Wright v.United States*** (809 F2d 425, 87-1 US Tax Cas ¶ 9130), critical of petitioner Wright, the court held:

> [m]erely because a corporate officer has check-signing responsibilities and his corporation is in financial trouble, it does not follow that he can be held liable for any and all failures to pay withholding taxes. . . . But if a responsible officer knows that the corporation has recently committed such a delinquency and knows that since then its affairs have continued to deteriorate, he runs the risk of bing held liable if he fails to take any steps either to ascertain, before signing checks , what the state of the tax withholding account is, or to institute effective financial controls to guard against nonpayment.

Wright did neither of these things, and Cornell did both. Once any sign of delinquency was uncovered, he immediately took steps to prevent the continued deterioration, and safeguarded the company by firing those who committed the misdeeds and hired professionals to ascertain the problem issues.

Petitioner's actions fall short of being "willful" as that term is used in Tax Law § 685(g). In ***Gallo*** (***supra***), the Tax Appeals Tribunal said that the question of willfulness is directly related to the issue of responsibility because only a responsible officer can consciously and voluntarily decide not to collect and pay over the tax. The Tribunal therein stated:

> The essence of the willfulness standard is that the person must voluntarily and consciously direct the trust fund monies from the State to someone else. There need not be any particular motive for doing so, only the result that the State has not received the monies held in trust for it. Mere negligence is not enough (***Matter of Gallo***, ***supra***).

Lack of actual knowledge negates a finding that the act was voluntarily or consciously done by petitioner unless it is determined that the officer recklessly disregarded his corporate responsibilities including the responsibility to see that taxes were paid (***Matter of Capoccia v. State Tax Comm.***, ***supra***; ***Matter of Ragonesi v. State Tax Comm.***, ***supra***).

Once again, just as in the case of personal responsibility, the resolution of the issue is driven by the facts and circumstances of each case. In ***Gallo***, the responsible officer had delegated responsibility for the payment of withholding tax to his business manager, who proceeded to conceal the fact that he was not paying the taxes. Such deceit was found to negate a finding that the failure to pay the withholding tax arose from Mr. Gallo's reckless disregard for his responsibility, i.e., his actions were not considered willful. In the instant matter, I find that petitioner fully discharged his responsibilities and duties to the best of his ability and in a conscious effort to pay the withholding taxes. Surreptitious plans by others, namely Michael Moore and Skip Reitmeier, beyond his power, control and knowledge, do not negate this, and his actions cannot be considered willful.

D. The petition of James Cornell is hereby granted and the notices of deficiency dated March 20, 2000 are canceled.

DATED: Troy, New York
January 6, 2003

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE